**2001 Country Reports on Economic Policy and Trade Practices**
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# UNITED KINGDOM

## Key Economic Indicators

(Billions of U.S. dollars unless otherwise noted)

| | 1999 | 2000 | 2001 |
|---|---|---|---|
| *Income, Production and Employment:* | | | |
| Nominal GDP | 1,443.6 | 1,441.8 | 1,447.0 |
| Real GDP Growth (Pct) | 2.2 | 3.1 | 1.9 |
| GDP by Sector: 3/ | | | |
| Agriculture | 15.1 | N/A | N/A |
| Mining | 29.1 | N/A | N/A |
| Manufacturing | 239.3 | N/A | N/A |
| Services | 924.9 | N/A | N/A |
| Government | 65.1 | N/A | N/A |
| Per Capita GDP (U.S.$) | 24,262 | 24,130 | 23,205 |
| Labor Force (Millions) | 30.1 | 30.1 | 30.1 |
| Unemployment Rate (Pct) | 4.1 | 3.6 | 3.2 |
| *Money and Prices (Annual Percentage Growth):* | | | |
| Money Supply Growth 4/ | 11.7 | 4.6 | 6.1 |
| Consumer Price Inflation | 1.6 | 2.9 | 2.1 |
| Exchange Rate (US$/BPS – Annual Average) | 1.62 | 1.52 | 1.42 |
| *Balance of Payments and Trade:* 5/ | | | |
| Total Exports FOB | 252.1 | 273.4 | 288.7 |
| Exports to United States | 39.4 | 43.9 | 43.5 |
| Total Imports CIF | 287.8 | 315.4 | 340.9 |
| Imports from United States | 39.6 | 41.6 | 41.6 |
| Trade Balance | -26.2 | -28.8 | -37.7 |
| Balance with United States | -0.2 | 2.3 | 1.9 |
| Total Public Debt/GDP (Pct) | 44.7 | 42.1 | 39.6 |
| Fiscal Deficit/GDP (Pct) | 1.7 | 2.1 | 0.8 |
| Current Account Deficit/GDP (Pct) | -1.1 | -1.7 | -1.5 |
| Gold and Foreign Exchange Reserves | 34.1 | 37.6 | 46.7 |
| Aid from United States | 0 | 0 | 0 |
| Aid from All Other Sources | 0 | 0 | 0 |

1/ Converted from British Pound Sterling (BPS) at the average exchange rate for each year.
2/ All 2001 figures are forecasts, unless otherwise indicated.

3/ Gross value added at current basic prices. “Agriculture” includes hunting, forestry and fishing. “Services” includes electricity, gas, and water supply, construction, wholesale and retail trade, transport and communication, financial intermediation, adjustment for financial services, education, health, social work, and other services. “Government” reflects only public administration and defense.

4/ Notes and coins in circulation in the United Kingdom plus banks’ official deposits with the Banking Department.

5/ Merchandise trade, converted at average exchange rate for the applicable year.

Sources: The Oxford Economic Forecasting and London Business School 2000 Economic Outlook, the UK Office for National Statistics, and the Bank of England.

*1. General Policy Framework*

The United Kingdom (UK) has the fourth largest economy in the industrialized world, with an estimated nominal GDP of about $1.45 trillion in 2001. The UK's 59.8 million inhabitants live in an area the size of New York and Pennsylvania (which have a population about half the size). Per capita income is forecast to be approximately $28,144 in 2001.

The UK is in its ninth year of economic expansion since the 1991-92 recession. Real GDP growth was 1.9 percent in 2001, down from 2.2 and 3.1 percent in 1999 and 2000, respectively. The two largest impacts on the British economy have been the global economic slowdown, including the downturn of the U.S. economy, and the outbreak of foot and mouth disease. The slowdown in the U.S. economy affects the UK through export markets as U.S. imports compose approximately three percent of overall GDP. Moreover, overinvestment in telecommunications infrastructure, including prices paid for third generation licenses by British firms, could exacerbate the UK slowdown.

Since the outbreak of foot and mouth disease in February 2001, some 5.8 million animals have been culled. This is approximately 13 percent of the total livestock population in the country, although the majority of the cull is sheep. The impact of the outbreak is expected to lower GDP only 0.1 percent as the agricultural sector makes up just 2.7 percent of overall economic output. The indirect effects of the foot and mouth outbreak could prove more damaging in the tourism sector, which accounts for 4.0 percent of GDP.

The main engine of growth in the UK economy is the services sector, which accounts for about 75 percent of GDP. Business, finance, transport, storage and communication services were the principal drivers in service growth, as the sector continued to strengthen into 2001. However, the service sector is expected to slow to 3 percent growth in 2001 from 3.4 percent last year. The service sector has proven more resilient than manufacturing, which makes up 20 percent of GDP. It is believed that the service sector will account for most of GDP growth in 2001 as manufacturing is close to technical recession. One reason for this is the weakness of the euro relative to the pound sterling, which has made exports to the EU more expensive. Another is the dramatic fall in telecommunications equipment demand that has led to large manufacturing job losses in this sector.

Since breaking even in 1998, the current account continues to be in deficit. In 1999, the deficit equaled 1.2 percent of GDP. A U.S. slowdown could contribute to a widening of the UK current account deficit, which is expected to be 1.5 percent of GDP in 2001. This is, however, modest compared to a level of 4.6 percent of GDP in 1989. For the second year in a row, the UK is forecasted to have a trade surplus with the United States of 1.9 percent.

Government consumption rose at an annual rate of 3.2 percent in the first quarter of 2001. This higher government consumption and investment is expected to boost GDP growth in 2001, with increases in pensions spending, and changes to the working families tax credit. Unemployment has fallen every year since 1993. In 2001, unemployment is expected to be 3.2 percent. Employment expanded by 218,000 new jobs during the first eight months of 2000, and more people are employed in Britain than ever before.

Fiscal Policy: The Labour government has adhered to its "Code for Fiscal Stability" since it was elected into office in May 1997, as the balance of current government receipts and expenditures has turned into a surplus. Outstanding public sector net debt was reduced to 31.6 percent of GDP in March 2001 from a recent peak of 44.4 percent in mid 1997. However, higher spending, together with the impact of slower economic growth on government revenues, will lead to a sharp reduction in the budget surplus.

Tax Policy: Chancellor Gordon Brown's budget plan for 2000-2 sought to take advantage of the booming economy in order to provide additional tax cuts and credits. In March 1999, the Chancellor announced a new 10 percent “starting rate” of tax, the lowest since 1962, on the first 1,500 pounds (now 1,520) of taxable income. In March 2000, the budget included further increases in public spending for health and education along with more cuts in taxes. In keeping with the Labour government’s promise from last year, the income tax “basic rate” (applied to taxable earnings from 1,521 to 28,400 pounds) will be reduced from 23 percent to 22 percent for the 2000-2001 tax year. The government will also extend the New Deal and Working Families Tax Credit Program in 2001. Many new measures will be established to ease the transition between coming off welfare and going to work, including one-off grants of up to 400 pounds and efforts to assist in purchasing cars, tools or interview suits. In line with the government’s central theme of promoting modernization through investment in high-tech industries, the Chancellor announced that capital gains taxes for businesses in operation over five years will be reduced from 40 percent to 10 percent (previously only companies in business over ten years received this lower rate). These plans are predominantly aimed at helping the working poor; high-income earners will experience a greater tax burden through a number of tax increases.

Monetary Policy: In 1997, Chancellor Gordon Brown granted the Bank of England independence in setting monetary policy to achieve the inflation target of 2.5 percent. The Bank of England's dominant policy instrument is its ability to set the interest rate each month in order to maintain price stability. Inflation remains under control, averaging three percent for 2000 and two percent in 2001. This has allowed the Bank of England to reduce interest rates to the lowest level in years. The Monetary Policy Committee surprised the financial markets in August by cutting UK interest rates to five percent. In September, the Committee cut interest rates again by

25 basis points to 4.75 percent as a reaction to the decline of international financial markets caused by the September 11 terrorist attacks in the United States.

*2. Exchange Rate Policy*

Since the UK's withdrawal from the European Union's (EU) Exchange Rate Mechanism in January 1993, the pound has floated freely. Sterling appreciated significantly between the beginning of 1996 and early-to-mid-1998, with the trade-weighted exchange rate index (1990=100) rising from a low of 83.5 to a high of 107.1 in April 1998. The pound lost ground against the dollar in 2001, however forecasts show a gradual recovery between 2002-2005. In contrast, the pound weakened against the euro in 2001 and continued weakening is predicted in the following three years.

The current government favors joining the new European common currency in principle, provided that the following five economic tests are met:

1) There is convergence between EU and UK business cycles and economic structures.
2) The EMU provides flexibility for the British economy.
3) Membership has a positive investment impact.
4) The British financial services industry is sufficiently prepared for entry.
5) Membership promotes growth, stability, and employment.

At present, the British public is divided on the issue.

*3. Structural Policies*

The UK economy is characterized by free markets and open competition, which the government actively promotes within the EU and international fora. The UK's labor market flexibility and relatively low labor costs are often credited as major factors influencing the UK's success in attracting foreign investment. However, relatively low manufacturing labor productivity remains a concern.

Market forces establish prices for virtually all goods and services. The government still sets prices for services in those few sectors where it is still a direct provider, such as urban transportation. In addition, government regulatory bodies monitor prices charged by telecommunications firms and set price ceilings for electric, natural gas, and water utilities. The UK's participation in the EU's Common Agricultural Policy significantly affects the prices for raw and processed food items, but prices in wholesale and retail markets are not fixed for any of these items. Further liberalization of the financial services, air travel, energy, and telecommunications sectors are all economic goals of the Labour government.

The main economic focus of the Labour government, re-elected in May 2001, was welfare reform, trade liberalization, and productivity improvement. The relationship with Europe also dominates the economic landscape of the UK, particularly on the question of whether the UK should adopt the single European currency.

As the European Union (EU) continues to integrate, instances of friction have arisen between the UK and other member states due to the UK's more flexible economic environment. UK labor laws, for example, allow employers greater leeway to reduce staff than do their counterparts elsewhere in the EU. The UK also has disagreed with other member states on tax and other policies.

Private sector production, transportation, warehousing, communications, and distribution facilities infrastructure in the UK are adequate, although some of the physical assets employed show the need for repair and replacement. Much of the responsibility for public sector infrastructure in the UK has been transferred to the private sector and to independent executive agencies that are accountable to government departments. To supplement government investment, Public Private Partnership (PPP) initiatives have enabled private finance initiative schemes to create viable business entities from public assets at minimal cost to the government. Since 1997, the Department of Trade and Industry reports that over 150 contracts have been signed. The recent establishment of a PPP for air traffic control was extremely controversial, and the public worries that similar schemes will be established in health and other services.

### *4. Debt Management Policies*

The UK has no meaningful external public debt. London is one of the foremost international financial centers in the world, and British financial institutions are major intermediaries of credit flows to developing countries. The government is an active participant in the Paris Club and other multilateral debt negotiations.

### *5. Significant Barriers to U.S. Exports*

Structural reforms and open market policies make it relatively easy for U.S. firms to enter UK markets. The UK does not maintain any barriers to U.S. exports other than those implemented as a result of EU policies.

Within the European Union, the European Commission has authority for developing most aspects of EU-wide external trade policy, and most trade barriers faced by U.S. exporters in EU member states are the result of common EU policies. Such trade barriers include: the import, sale and distribution of bananas; restrictions on wine exports; local (EU) content requirements in the audiovisual sector; standards and certification requirements (including those related to aircraft and consumer products); product approvals and other restrictions on agricultural biotechnology products; sanitary and phytosanitary restrictions (including a ban on import of hormone-treated beef); export subsidies in the aerospace and shipbuilding industries; and trade preferences granted by the EU to various third countries. A more detailed discussion of these and other barriers can be found in the country report for the European Union.

The U.S.-UK Bilateral Aviation Agreement is highly restrictive, particularly in limiting the number and access of carriers serving London Heathrow Airport and the European destinations beyond UK airports to which U.S. airlines may fly. Talks since 1994 towards an Open Skies agreement have not been successful but negotiations are continuing. The U.S. goal continues to be to negotiate an agreement that benefits as many cities, airlines, and consumers as possible.

*6. Export Subsidies Policies*

The government opposes export subsidies as a general principle, and UK trade-financing mechanisms do not significantly distort trade. The Export Credits Guarantee Department (ECGD), an institution similar to the Export-Import Bank of the United States, was partially privatized in 1991.

The UK's development assistance program has certain "tied aid" characteristics. Agricultural and humanitarian assistance are not tied. In addition, various waivers of tied aid requirements are available to UK officials administering development assistance.

*7. Protection of U.S. Intellectual Property*

UK intellectual property laws are strict, comprehensive, and rigorously enforced. The UK is a signatory to all relevant international conventions, including the convention establishing the World Intellectual Property Organization, the Paris Convention for the Protection of Industrial Property, the Berne Convention for the Protection of Literary and Artistic Works, the Patent Cooperation Treaty, the Geneva Phonograms Convention, and the Universal Copyright Convention.

New copyright legislation simplified the British copyright process and permitted the UK to join the most recent text of the Berne Convention. The United Kingdom's positions in international fora are very similar to those of the United States.

*8. Worker Rights*

a. *The Right of Association:* Unionization of the work force in the UK is prohibited only in the armed forces, public sector security services, and police force.

b. *The Right to Organize and Bargain Collectively:* Nearly seven million workers, about one-third of the work force, are organized. Employers are barred from discriminating based on union membership. The Employment Relations Act of 1999 determines under what conditions an employer must bargain with a trade union. Employers are no longer allowed to pay workers who do not join a union higher wages than union members performing the same work. In 2001, the UK agreed to an EU directive that will compel employers to consult their workforces on issues such as layoffs and plant closures.

Unions are legally responsible for members' industrial actions, including unofficial strikes, unless union officials repudiate the action in writing. Unofficial strikers can be legally dismissed, and voluntary work stoppage is considered a breach of contract. Most union contracts are of much shorter duration (typically one year), than in the United States. Like the United States, however, most collective bargaining can occur on virtually any issue at any level -- unlike many other European states where industry-wide, national bargaining is still widely practiced.

Unions do not have immunity from prosecution for secondary strikes or for actions with suspected political motivations. Actions against subsidiaries of companies engaged in bargaining disputes are banned if the subsidiary is not the employer of record. "Closed shops," which restrict employment to union members, are illegal.

c. *Prohibition of Forced or Compulsory Labor:* Forced or compulsory labor is unknown in the UK.

d. *Minimum Age for Employment of Children:* Children under the age of 16 may work in an industrial enterprise only as part of an educational course. Local education authorities can limit employment of children under 16 if working will interfere with the child's education.

e. *Acceptable Conditions of Work:* The UK's first official national minimum wage took effect on April 1, 1999. As of October 1, 2001, the minimum wage became 4.10 pounds, with a special "development rate" of 3.50 pounds for 18 to 21 year-olds. Daily and weekly working hours are limited by law, according to an EU directive outlawing mandatory workweeks longer than 48 hours.

The Health and Safety at Work Act of 1974 banned hazardous working conditions. A Health and Safety Commission submits regulatory proposals, appoints investigatory committees, conducts research, and trains workers. The Health and Safety Executive enforces health and safety regulations and may initiate criminal proceedings. The system is efficient and conscientious. Unions have a legal right to appoint safety representatives where an employer has recognized their union. In non-unionized workplaces, the employer must still consult employees but can choose to do so directly or set up a system of employee representatives on health and safety, whose rights are more limited than union safety representatives.

f. *Rights in Sectors with U.S. Investment:* U.S. firms operating in the UK are obliged to obey all worker rights legislation.

**Extent of U.S. Investment in Selected Industries** -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 2000

(Millions of U.S. Dollars)

| Category | Amount |
|---|---|
| Petroleum | 15,749 |

| | | |
|---|---|---|
| Total Manufacturing | | 50,994 |
| Food & Kindred Products | 4,815 | |
| Chemicals & Allied Products | 16,170 | |
| Primary & Fabricated Metals | 2,188 | |
| Industrial Machinery and Equipment | 9,022 | |
| Electric & Electronic Equipment | 3,977 | |
| Transportation Equipment | 4,319 | |
| Other Manufacturing | 10,504 | |
| Wholesale Trade | | 7,953 |
| Banking | | 9,930 |
| Finance/Insurance/Real Estate | | 100,273 |
| Services | | 17,258 |
| Other Industries | | 31,227 |
| TOTAL ALL INDUSTRIES | | 233,384 |

Source: U.S. Department of Commerce, Bureau of Economic Analysis.